No. 436

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Supreme Court of the United States.

Brief of Newman for Resp'ts

OCTOBER TERM, 1899.

No. 436

Filed Nov 20, 1899.

Petition for Certiorari.

UNITED STATES RUBBER COMPANY, A CORPORATION, L. CANDEE & CO., A CORPORATION, AND METROPOLITAN NATIONAL BANK OF CHICAGO, A CORPORATION,

Petitioners,

vs.

AMERICAN OAK LEATHER COMPANY, PFISTER & VOGEL LEATHER COMPANY, THOMAS E. WILDER AND JOHN WILDER, CO-PARTNERS AS WILDER & COMPANY, EAGLE TANNING WORKS, UNITED STATES LEATHER COMPANY, LAMBEAU LEATHER COMPANY, THE BARBER BROS. COMPANY, BOSTON BLACKING CO., BULLETIN & GOOD ROADS, CARSON-PIRIE MONTHLY CO., CARVER COTTON GIN CO., CALVERT LITHOGRAPHING & ENGRAVING CO., B. E. COLE & CO., COLBURN, FULLER & CO., CONSUMERS' BOX MANUFACTURING CO., THE CONTINENT SHOE COMPANY, CROOKS, ROOT & CO., CYCLING GAZETTE, EASTON BOOT & SHOE COMPANY, ESTABROOK-ANDERSON SHOE CO., FARNSWORTH, HOYT & CO., I. P. FARNUM, C. C. FARWELL & CO., P. A. FIELD & CO., FLETCHER MF'G. CO., A. F. GALLUM & SONS, H. M. GEORGE & CO., GOLDSMITH, ROSENBUSH & LEVIE, GOODYEAR RUBBER CO., THE R. J. GUNNING CO., M. L. HILLER & SONS, A. J. MARCUS & CO., J. & H. MAYER, H. MICHAELS & CO., MILWAUKEE TACK CO., W. J. McBRIDE, PLIABLE SHOE CO., ROUSE, MANIERE, WILLIAMS & CO., SHATTUCK & BINGER, A. W. SHAW & CO., T. J. SHAY & CO., THE SINGER MANUFACTURING COMPANY, W. W. SPAULDING SPINNEY, VIRTUE & CO., STOWE, BILLS & HAWLEY, THILMANY PULP & PAPER MILLS, TUBULAR RIVET & STUD COMPANY, UNIVERSITY OF CHICACO WEEKLY, GEORGE H. VAN PELT, WACHUSETT MILLS, WEIR BROS. PAPER CO., CONSOLIDATED HAND METHOD LASTING MACHINE CO., HILLIARD & MERRILL, TRIPP GIANT LEVELLER CO., DRY GOODS REPORTER CO., E. H. VAN INGEN & CO., et al.,

Respondents.

BRIEF AND ANSWER OF THE ABOVE NAMED RESPONDENTS TO PETITION FOR CERTIORARI.

JACOB NEWMAN,
FRED'K A. SMITH,
HORACE K. TENNEY,
WM. J. MANNING,
Counsel for Respondents.

Geo. Hornstein & Co., Printers, Chicago.

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Counsel for Respondents.

Brief and Answer of Respondents to the Petition for a Writ of Certiorari.

May it please the Court:

This is an application, in a case involving *merely private interests, for the issuance of a writ of certiorari to review a finding of the Circuit Court of Appeals as to the existence of fraud in fact*—a finding which *ex vi termini* and under the authorities is a bald finding of fact.

Smith v. *Craft*, 123 U. S., 440.

The existence of fraud in fact necessarily involves and implies the existence of fraud in law. In other words, the petitioners having been found guilty of fraud in fact, it is submitted with confidence that the question whether or not their preferences were legally fraudulent does not, for the purposes of this application, attain even the dignity of an academic question and is wholly immaterial.

Neither in their petition, nor in their brief, have the petitioners made a full and accurate statement of the facts disclosed by the record, or given the gist of the opinion of the Court of Appeals. However, the record of that court is expressly made a part of the petition and necessarily controls the meager and somewhat elusive allegations of the petition as to the questions of fact and propositions of law involved. We shall, therefore, not encumber this answer with a de-

tailed statement of facts, but respectfully refer the court to the opinion of the Court of Appeals, which we have inserted for convenience of reference in an Appendix to this brief, *infra*.

An examination of this opinion will demonstrate how unfounded is the claim of counsel that the Court of Appeals did not overrule the Master's findings on the subject of *fraud in fact*, and how baseless is their other claim that the learned Judge who wrote the majority opinion ignored the distinctions between fraud in law and fraud in fact.

We deem it advisable, however, to call attention here to a few specific items in which we think the petition, standing alone, is calculated (no doubt unintentionally) to create an erroneous impression.

1. The errors assigned by the respondents on their cross appeal were numerous, and (among other things) elaborately attacked the Master's report and the decree of the Circuit Court for failure to find *fraud in fact* on the part of the petitioners. (Rec., 684 to 692.)

2. We are satisfied that the statements of the petition as to the point actually decided by the Court of Appeals, and the basis of that decision, are incorrectly stated in paragraphs 8, 9 and 10 of the petition. These inaccuracies are discussed in the body of this brief.

3. We think also that the ground of Mr. Justice Brown's dissent is incorrectly stated in paragraph 8 of the petition. His dissenting opinion, as we read it, amounts to a declaration that the learned Justice did not find, as a matter of fact, that the petitioners were guilty of *fraud in fact*. This appears not only from his express statement, that he was not satisfied

from the *testimony* that "an actual fraud upon the "general creditors was intended," but also from the fact that he relies, as the basis for his conclusion that petitioners should *not* be postponed, upon *White* v. *Cotzhausen* (129 U. S., 329), and *Streeter* v. *Jefferson County Bank* (147 U. S., 36), cases where the preferred creditors were allowed to share because they were held to be *innocent of fraud in fact and guilty only of legal fraud.*

I.

This is an application for the issuance of a writ of certiorari, to review a decision of the Court of Appeals on a question of fact.

Counsel claim that there are two questions in this case:

First Question: Whether the petitioners' preferences were constructively fraudulent. (Petn. p. 5, par. 9.)

Second Question: Whether "the conduct of the "petitioners * * * was such as to justify the "court, when distributing the insolvent estate, in "postponing their claims to those of the other cred- "itors." (Petitioners' Brief, p. 1.)

The court will note that in none of the opinions filed in this case has any judge defined this "second question" in the language used by petitioners. On the contrary, the judges who decided that the petitioners should be postponed, bottomed their decision on a *concrete matter of fact*, and declared in clear, strong and direct language that the petiti-

oners were guilty of *fraud in fact*, and should therefore be postponed in the distribution of the estate.

In concluding, the Court of Appeals, through Judge Woods, summed up the case as follows:

> "It is clear that the Rubber Companies were "guilty of *fraud in fact*, and as against subse- "quent creditors of the Fargo Company, should "not be allowed to share in the fund for distri- "bution, and for the reasons stated the Bank "should likewise be postponed." (Appendix, *infra*, p. 29.)

Not only is the existence of actual fraud thus flatly found as the final conclusion drawn from an elaborate review of the evidence, but the opinion itself is substantially made up of a series of findings of actual fraud.

Mr. Justice Brown, on the other hand, bases his dissent on the non-existence of *fraud in fact*, saying, in his dissenting opinion,

> "I find no *testimony to satisfy me that an* "*actual fraud* upon the general creditors was in- "tended." (Rec., 736.)

He therefore concludes that the petitioners should neither enjoy their fraudulent preferences, nor be postponed, but should share *pro rata* with the other creditors.

The "second question" in the case—the only question upon which there has been any division of opinion—has thus been defined by the judges themselves as a question of fact to be determined from "the testimony" in the record. In a leading case this Court said:

"The question of fraud or no fraud involved a ques-

"tion of fact which, if this case had been on the com-"mon law side of the court and either party had de-"sired it, *must have been submitted to a jury.*"

Smith v. *Craft*, 123 U. S., 441.

That the judgment of the Court of Appeals is sound, if its conclusion as to the existence of actual fraud be right, can not be open to controversy. If the petitioners were guilty of fraud in fact in obtaining their preferences, there can be no doubt that they should be postponed in the distribution of the estate. All the cases agree that a creditor guilty of actual fraud in obtaining a preference will not be permitted to share in the estate until the innocent creditor is paid in full; this is the rule even where the guilty creditor's fraud did not create the innocent creditor's demand.

But the case at bar is much stronger. Here all the innocent creditors were *drawn in* to give credit, during the period the secret and fraudulent scheme was in full operation, and were so *drawn in* through the deception perpetrated by means of such secret and fraudulent scheme. Substantially every dollar due these creditors (Master's report, petitioner's brief, page 8) was created during this period, as the direct result of the deceitful scheme devised by the petitioners and fully described in the opinion of the Court of Appeals. It is this scheme, and the acts and motives of the petitioners in its creation and execution, which the Court of Appeals condemned and found fraudulent in fact. The authorities are uniform to the effect that under such a state of facts, the *drawn-in* creditors must be paid in full before the

guilty parties receive a dollar to apply on their demands.

Gill v. *Griffith*, 2 Md. Ch., 281.
Bacon v. *Harris*, 62 Fed. Rep., 105.
Simon v. *Openheimer*, 20 Fed. Rep., 556.
Ramsey v. *Town*, 20 Fed. Rep., 558.
Argall v. *Seymour*, 4 McCrary, 58.
Goll & Frank Co. v. *Miller*, 87 Ia., 426.
Falker v. *Linehan*, 88 Ia., 641.
Liddle v. *Allen*, 90 Ia., 741.
Root v. *Hurl*, 62 Mich., 423.
Blennerhasset v. *Sherman*, 105 U. S. 118.
Hilliard v. *Cagle*, 46 Miss., 309.
Lehman v. *Van Winkle*, 92 Ala., 443.
Stock Growers' Bank v. *Newton*, 13 Colo., 255.
Walton v. *First Nat'l. Bank*, 13 Colo., 265.

Counsel, if we understand their brief, do not seriously controvert these legal propositions. What counsel really complain of is the *verdict* "guilty of fraud "in fact" rendered by the Court of Appeals. At times they attack that verdict as unsustained by the evidence, etc.; at other times they ignore the *verdict* altogether, and cite and review authorities dealing with questions of constructive fraud, and attempt to apply these authorities to their own view of the facts and argue therefrom that petitioners were not guilty of even constructive fraud. But that the decree of the Circuit Court of Appeals was right if its verdict on the question of *fraud in fact* was right, counsel do not attempt to deny.

The two questions, which petitioners assert constitute the basis for this application, should therefore be stated as follows:

First Question: Whether the preferences obtained by the petitioners were constructively fraudulent.

Second Question: Whether or not the petitioners were guilty of *fraud in fact*.

But, in view of the character of this "second question" the existence of the first is a matter of minor importance and immaterial to this application; the greater includes the less. The existence of fraud in fact—when adjudged—necessarily carries with it the existence of fraud in law. Any transaction which is fraudulent in fact is necessarily fraudulent in law. If the petitioners were guilty of actual fraud, then they were necessarily guilty of the lesser wrong-doing of constructive fraud.

It is clear then that the main controlling question on this application for a writ of *certiorari* is a question of fact—*the existence of fraud in fact*. This question has been decided against petitioners by the verdict "guilty" rendered by the Court of Appeals. Unless and until that question of fact can be retried, the question of fraud in law is not before this Court, and there is no controversy as to the propriety of postponing petitioners in the distribution of the fund in the hands of the receiver. This application, therefore, amounts to a request that this Court shall issue its writ of *certiorari* to retry this question of fact.

II.

The Rules Announced by this Court Governing the Issuance of Writs of Certiorari.

The important and decisive inquiry, on this application, is not as to the correctness of the lower court's decision, but as to whether or not the case at bar involves such questions as bring it within that class of cases which this Court has declared may be brought up and heard on *certiorari*. While the power of the Court to issue the writ may not be denied, the exercise of that power in a given case is a matter in which the parties in that case have a substantial interest; and we conceive it to be as much a matter of right for the respondents to have the application decided by the rules which the Court has heretofore laid down for its own guidance, as it is for the petitioners to make the application.

1. It will be well, at this point, to refer to the principles which this Court has laid down as its guide in the exercise of the power to grant the writ of *certiorari*. For while these principles and decisions are necessarily familiar to the Court, the form in which they have been stated serves to show how widely divergent is the case at bar, from any case in which this Court has declared that the writ should issue. In the leading cases on this subject, these rules have been defined as follows:

(1.) The power to issue writs of *certiorari* "*is a power which will be sparingly exercised.*"

(2.) This power will be exercised only when:

(*a*) "*The circumstances of the case satisfy us that the importance of the question involved;*" or

(b) "*The necessity of avoiding conflict between "two or more courts of appeal;*" or

(c) "*Between courts of appeal and the courts of "the State;*" or

(d) "*Some matter affecting the interests of this "Nation in its internal or external relations.*"

"*Demand such exercise.*"

Forsyth v. *Hammond*, 166 U. S., 514, citing *Lau Ow Bew, petitioner*, 141 U. S., 587.

In re Woods, 143 U. S., 202.

Lau Ow Bew v. *U. S.*, 144 U. S., 47.

Amer. Constr. Co. v. *Jacksonville Ry. Co.*, 148 U. S., 372.

Accordingly this Court has granted a writ of *certiorari* where the Court of Appeals for the Seventh Circuit, and the Supreme Court of the State of Indiana had reached opposite conclusions as to whether, or not a tract of land was included within the municipal limits of the City of Hammond, Indiana, where "all the unfortunate possibilities of conflict "and collision which might arise from these adverse "decisions, were suggested;" when the application for *certiorari* was made.

Forsyth v. *Hammond*, 166 U. S., 515.

Lau Ow Bew, Petitioner, 141 U. S., 582.

Lau Ow Bew v. *U. S.*, 144 U. S., 47.

On the other hand, the writ has been refused, where it was sought to have this Court pass upon the law of the state of Minnesota as to *res adjudicata*, and Master and Servant, the court saying:

"But we do not regard the inquiry as to "whether it was settled law in the State of Min- "nesota that a judgment of dismissal in a former

"suit, such asas pleaded here, was not a bar to a "second suit upon the same cause of action, or "whether thhe law in respect of recovery by a "servant agaainst his master for injuries received "in the courrse of his employment, was properly "applied on t the trial of this case, as falling with- "in the categgory of questions of *such gravity and* "*general imppportance* as to require the review of "the conclusisions of the Circuit Court of Appeals "in referencce to them."

In re Woods, 143 U. S., 205.

2. This Court has twice said in effect that the issuance of a writ of *certiorari* by this court, is governed by rules distinctly aanalogous to those determining the question as to whether or not a Circuit Court of Appeals should certifify a question to the Supreme Court for its instructiona.

For illustrationa, in *Lau Ow Bew's Case*, this Court, reviewing the circcumstances under which it was proper for the writ of *certiorari* to issue, said:

"It is evvident that it is solely questions of "*gravity* anand *importance*, that the Circuit Court "of Appeals should certify to us for instruction; "and that itit is only when such questions are in- "volved thaat the power of this court to require a "case in which the judgment and decree of the "Court of Appeals is made final, to be certified, "can be prroperly invoked. The inquiry upon "this applicication, therefore, is whether the mat- "ter is of sufficient importance in itself, and suf- "ficiently open to controversy to make it the "duty of thhis court to issue the writ applied for "in order tthat the case may be reviewed and de- "termined as if brought here on appeal, or writ "of error."

Lau Ow Bew, Petitioner, 141 U. S., 586.

So, likewise, in the *Hammond* case *(supra)*, the Court had the same questions before it, and quoted with approval, in the course of the argument, the language used in *Lau Ow Bew's Case*, and avowedly considered its action in passing upon the issuance of a writ of *certiorari* in the *Hammond* case, as properly regulated and governed by the analagous rules applicable to the certification, by the Circuit Court of Appeals, of questions to this Court for its instruction.

Inasmuch as this Court has repeatedly said that only questions of *gravity* and *importance* should be certified up by the Circuit Court of Appeals, and that the writ of *certiorari* should issue from this Court only to review questions of *gravity* and *importance*, it is clear that this Court intends to give the phrase, "questions of gravity and importance," the same meaning in both connections. In other words, that the *gravity* and *importance* which the question should possess in order to induce this Court to grant the writ of *certiorari* is the same kind of *gravity* and *importance* which would justify the Court of Appeals in certifying the same question up to this Court for instruction.

This Court has frequently said that for the reasons above stated, it will not under such a certificate, review, or pass upon even a question of mixed law and fact, nor permit the Circuit Court of Appeals to compel this Court to pass in any way, directly or indirectly, upon the *issues of fact* in the record, although the decision of such issues might be dependent on the determination of some question of law.

Cross v. *Evans*, 167 U. S., 60.

U. S. v. *Pacific Ry. Co.*, 168 U. S., 505.

McHenry v. *Alford*, 168 U. S., 651.
Smith v. *Craft*, 123 U. S., 436.
Jewell v. *Knight*, 123 U. S., 435.

It seems an inevitable deduction from the foregoing that this Court does not consider even questions of mixed law and fact, questions of such *gravity* and *importance* as to justify either the Circuit Court of Appeals in certifying such questions to this Court, or to demand the issuance by this Court of the writ of *certiorari* for their review. A *fortiori*, this Court will never issue the writ to review a mere question of fact. In other words, this Court will not bring up a case for review by *certiorari* unless the case hinges concisely on some clean-cut proposition or propositions of law, of *gravity* and *importance* within the meaning of those words as defined by the decisions we have cited.

III.

The Application of the Foregoing Rules to the Controlling Question in this Record.

As we have already shown *supra*, p. 7, the controlling question on this application is what counsel call their "second question." Unless this "second question" comes within the category of questions which this Court will review by *certiorari*, as announced in its decisions, then the petition must be denied. Recognizing this situation, petitioners are forced to make the claim that their "second "question" is "of such gravity, importance "and frequent recurrence as to justify the de- "cision thereof by a greater unanimity of judicial

"opinion than exists in the said Seventh Circuit, and "that to that end, said question ought to be decided "by this court by means of a *certiorari* herein to said "Circuit Court of Appeals." (Petition, p. 4, par. 10.)

But we have further shown (*supra*, p. 4), that petitioners' "second question" is merely whether or not the Court of Appeals rightly found, from the evidence in the record, that the petitioners were guilty of fraud in fact, and that the existence of fraud in fact is a question of fact. *Smith* v. *Craft*, 123 U. S., 440; *Jewell* v. *Knight*, 123 U. S., 435. The lack of "unanimity" complained of consists merely in the circumstance that the trial judge found the petitioners not guilty of *fraud in fact*, and the Court of Appeals, one judge dissenting, found the petitioners guilty of *fraud in fact*.

When petitioners' "second question" is thus stated in plain language, no foundation is left for petitioners' claim that this "second question" is a question of "such gravity and frequent recurrence "that its settlement by a greater concord of judicial "opinion seems desirable." (Petitioners' brief, p. 2.) It is not perceived how a question as to whether or not the evidence in a given case demonstrates the existence or non-existence of fraud in fact, can be said to be a question of "frequent recurrence," because it is submitted with confidence that no two cases of fraud in fact present the same circumstances.

We note further that this court has never said nor suggested, so far as we have been able to learn, that the fact that a question was of "frequent recurrence" constituted any ground whatever for a writ of *certiorari*.

Generally speaking, the simplest questions are the questions of most "frequent recurrence": and the fact that a question arises frequently creates a strong presumption either that it has been settled by repeated adjudications, or is governed by elementary principles.

1. A controverted question of fact, *where only private interests are involved*, can not be a question of "gravity and importance" within the meaning of that expression as used by this Court.

2. There can be no conflict between two or more Circuit Courts of Appeal, or between the Circuit Courts of Appeal and the courts of a state, on the question as to whether or not the conclusions of fact drawn from a given record in a particular case, are correct, and there is no claim that such a conflict exists as to this "second question."

3. Where only private interests are involved, a question of fact can not be a "matter affecting the interests of this nation in its internal or external "relations."

We doubt whether this Court will ever extend the writ of *certiorari* so far as to take jurisdiction of a case because the Court of Appeals (one member dissenting) has reversed the Circuit Court on a question of fact. If it does, then we respectfully submit a radical departure will be made by this Court on the subject of *certiorari;* and every case which involves the motives, conduct, and good faith of the parties, will knock at the door of this Court. On what ground, we respectfully ask, will this Court deny writs of *certiorari* in that vast mass of litigation which involves mere questions of fact? Where will the court stop to protect itself against

the very evil which the Act creating the Court of Appeals was designed to cure?

IV.

The Question of Legal or Constructive Fraud—Petitioners' First Question.

1. While we are satisfied that petitioners' "first question," namely, the question of legal fraud, is swallowed up by the question of fraud in fact, we shall nevertheless briefly consider their "first question" as though it had some bearing on this application. We do so simply because the bulk of petitioners' brief and argument is devoted to this subject.

At the outset it must be noted that the question of legal or constructive fraud, in a case involving a multitude of evidentiary facts, is itself a question of mixed law and fact.

Jewell v. *Knight*, 123 U. S., 426.
Smith v. *Craft*, 123 U. S., 436.

So that even if it could be said that the question of legal or constructive fraud was a material question in the case, the petitioners would not thereby be advanced, for this Court will issue writs of *certiorari* to review, neither questions of fact, nor questions of mixed law and fact.

(Authorities cited *supra*, p. 11.)
Smith v. *Craft*, 123 U. S., 436.
Jewell v. *Knight*, 123 U. S., 434.

2. Counsel define this "first question" in their petition as follows:

"That the Circuit Court of Appeals decided

"that certain preferences acquired by means of "judgment notes by two of said petitioners were "constructively fraudulent, because, immediately "after the giving of said notes and as a part of "of the agreement between C. H. Fargo & Co. "and said petitioners which resulted in the giv- "ing of such preferences, clerks in the office of "counsel for said petitioners became and contin- "ued until the entry of said judgments, the ma- "jority of the board of directors of said debtor "corporation, without notice thereof to the gen- "eral creditors of said company." (Petn., par. 9.)

The opinion of the Court of Appeals (Appendix, *infra*) shows that these allegations in the petition are palpably incorrect. First. The Court of Appeals decided that all the preferences of all the petitioners were *fraudulent in fact*. Second. In the face of thisrecord, it is nothing short of absurd for counsel to allege that the reason which they give in their petition as the basis of the decision of the Court of Appeals on this "first question" was the whole, or even a moiety of the reasons that moved that court. It is sufficient to say that counsel do not even mention the important element of intentional secrecy in creating and executing the scheme in question; an element which was considered of great moment by the Court of Appeals.

Counsel's "first question," therefore, might well be disposed of by the suggestion that the allegations of the petition in that regard are squarely contradicted by the record.

3. Assuming, for the purpose of discussion—which we deny as a matter of fact—that counsel's erroneous contention as to the fact, or reason upon which the

court based its decision is correct, we will proceed to consider the grounds urged by petitioners for the issuance of the writ to review this question of constructive fraud. These grounds, as stated in the petition, are two-fold:

(1.) "Said question is one of gravity and import-"ance."

(2.) "Such decision is inconsistent with decisions "in similar cases of this court and of the Supreme "Court of Illinois." (Petn., par. 9.)

There never has been any dissent on the part of any one of the five Judges who passed on this case from the proposition that these preferences were at least fraudulent in law, and that therefore petitioners were not entitled to claim any priority by virtue of such preferences. This was the decision of Judge Grosscup on the application for a receiver and injunction (*American Oak Leather Co.* v. *C. H. Fargo & Co., et al.*, 77 Fed. Rep., p. 671), and reaffirmed in his opinion on the final hearing. Judges Woods, Jenkins and Showalter, sitting in the Circuit Court of Appeals, in the appeal from the order granting the preliminary injunction (53 U. S. App., 444; 27 C. C. A., 118), while expressly reserving their opinion on the question of fraud in fact, held that the petitioners were clearly guilty of constructive fraud; and in his dissenting opinion on the last appeal, Mr. Justice Brown found no difficulty in arriving at the same conclusion.

The contest in this case is over the proceeds of the assets of the Fargo Company in the hands of a receiver appointed in an ordinary, every day creditor's bill, based on a return "*nulla bona*." The petition-

ers complain that their preferential rights to this fund have been held constructively fraudulent, and set aside wholly on that ground. Assuming petitioners' assertion in this respect to be true (although it is squarely contradicted by the record), it would not seem that a holding that such preferences were constructively fraudulent could be said to be a question of "*gravity and importance*" under the decisions. If the question of constructive fraud be one of "gravity and importance" under the facts of this case, then it is a question of like "gravity and importance" in all creditors' bills pending in the Circuit Courts where preferences are attacked on the ground that the acts of the parties were fraudulent or tended to "hinder, delay or defraud" creditors. A question is not one of "gravity and importance" for the purpose of an application for *certiorari*, simply because it deeply concerns the private interests of the parties. As we understand the decisions (*supra*, pp. 8, 9), the only cases which this Court deems it proper to review on the ground of "gravity and importance" are cases which (either on account of the public importance of the particular case, or the indirect importance to the public generally of a final settlement by this court of the legal questions involved), can be said to be questions of grave public interest and importance. It is submitted that counsel's "first question" does not present these characteristics.

4. We come then to the other reason given: that the decision of this question on which five Judges have agreed, is inconsistent with decisions in similar cases decided by this Court, and by the Supreme Court of Illinois. Having made this bold declaration, petitioners should at the outset point out at least one de-

cision in the Supreme Court of Illinois, or in this Court, with which the decision of the Court of Appeals is inconsistent, and should specify, in some definite manner, the concrete particulars out of which the inconsistency is claimed to arise. Instead of so doing, counsel indulge in an elaborate argument on the merits of the case generally, as illustrated by an argumentative review of a large number of cases in this Court and in the Supreme Court of Illinois and other states, which counsel claim are more or less analogous in some particulars to some of the elements in the case at bar.

Taking the petition as it stands, the allegation in this particular is, that the Court of Appeals held the preferences constructively fraudulent because the control of the board of directors was placed in the hands of the petitioners' attorneys, without notice to the general creditors, and that such holding is in conflict with the decisions of this Court and the Supreme Court of Illinois.

Now, a review of the many decisions of this Court and the Supreme Court of Illinois, which are cited in the brief of petitioners' counsel, *fails to disclose a solitary case in which such a proposition was either directly or indirectly presented, or discussed.*

Without taking time to call attention to the specific authorities cited by counsel, we think no clearer showing of our position can be made than that found in the opinion of the Court of Appeals in the case at bar. The court starts out by saying that the validity of the preferences in question must be determined by the law of Illinois, and that the laws of that state authorize preferences by insolvent corpora-

tions; the court then takes up the different cases in Illinois which were cited below by counsel and are again cited in their brief here, and shows how plainly they are distinguished, in essential features relating to the question of fraud, from the case at bar, and say:

> "The decisions cited afford no precedent, direct "or inferential, in justification of the scheme in "question, the like of which, we believe, if ever "conceived, was never before brought into effec- "tive operation. As a judicially sanctioned or "commercially accepted possibility, in business, "it is unbelievable." (Rec., 723-5.)

5. But, if we turn from this incomplete and incorrect statement by petitioners of the question decided by the Court of Appeals and look at the record itself, and the opinion of that court, we find abundant additional material showing that petitioners' claim of conflict or inconsistency on this question, is wholly untenable. The elements of fraud in this case were not, as claimed by petitioners, confined to the mere change in the board of directors; that was in reality but one of many evidentiary facts showing the fraudulent conduct of petitioners. The character of the scheme can only be determined by considering all its numerous elements; its necessary consequences and results, and the motives and intentions of the parties to the scheme, as disclosed by the testimony, which is so ably reviewed by the Court of Appeals.

In conclusion we beg to say that the line of argument pursued by counsel seems to us wholly foreign to the question to be determined by the Court

on this application. Instead of confining themselves to the question in hand, and demonstrating or attempting to demonstrate that the case at bar comes within the class of cases in which a writ of *certiorari* should issue, counsel have seen fit to file with their petition a substantial *replica* of their brief and argument in the Court of Appeals, and have argued at length *on the facts*, in an endeavor to convince this Court that petitioners were either not guilty of fraud in any form, or at all events, not guilty of the kind of fraud of which they stand convicted. We do not deem it necessary, or proper on this application for a writ of *certiorari* to reply in detail to this line of argumentation. A satisfactory discussion of the merits of that conviction would demand an elaborate review of the facts disclosed by testimony covering 430 printed pages; would demand, in short, that respondents likewise file, in resisting this application, a substantial copy of their brief and argument on the *facts* in the court below. This of itself seems to us a conclusive answer that this case does not come within the class of cases in which this Court will issue the writ of *certiorari*.

Respectfully submitted.

JACOB NEWMAN,
FREDK. A. SMITH,
HORACE K. TENNEY,
WM. J. MANNING,
Counsel for Respondents.

Appendix.

IN THE UNITED STATES CIRCUIT COURT OF APPEALS, FOR THE SEVENTH CIRCUIT, NOS. 598, 599—JUNE SESSION, 1899.

No. 598:

United States Rubber Company, a corporation, L. Candee & Co., a corporation, and Metropolitan National Bank of Chicago, a corporation,
Appellants,
vs.
American Oak Leather Company, *et al.* *Appellees.*

Appeal from the Circuit Court of the United States, for the Northern District of Illinois, Northern Division.

No. 599.

American Oak Leather Company *et al.*, *Appellants,*
vs.
United States Rubber Company, L. Candee & Co., The Metropolitan National Bank of Chicago and C. H. Fargo & Co.
Appellees.

Cross Appeal.

Before Brown, Circuit Justice, and Woods and Jenkins, Circuit Judges.

We have here an appeal and cross appeal. They are from a final decree, rendered in conformity with the Master's report of his conclusions on the evidence, and in accord with the theory of the interlocutory order affirmed by this court, in *United States Rubber Co.* v. *Am. Oak Leather Co.*, 53 U. S. App., 444, 27 C. C. A., 118. The defendants, the

Rubber Companies, and the Metropolitan National Bank, dispute that theory and insist that the preferences which they obtained were valid. The original complainants and other creditors who intervened, have brought the cross-appeal and insist that the fund in court should be applied to the discharge of their demands, and that in so far as the decree permits the defendants to share in the fund it is erroneous. The character of the case, as now presented, is not deemed to be essentially different from what it was before, but a fuller statement of the facts is desirable.

The corporation, C. H. Fargo & Co., successor to a partnership of the same name, was organized in 1889, to do a mercantile business in Chicago. In 1893 it became embarrassed, and being largely indebted to the Rubber Companies, the United States Rubber Company of New Jersey, and L. Candee & Co. of Connecticut, and to the Metropolitan National Bank of Chicago, and being compelled to yield to the demand of the latter for security, executed judgment notes to the bank for $130,000, and to the Rubber Companies for sums aggregating $200,000, those companies not asking but accepting security because the Bank exacted it. The Fargo Company had an agreed line of credit with the Bank to the amount of $50,000, which was sometimes exceeded. The judgment notes given in 1893 were paid in part from time to time, and before the close of 1895 were surrendered and ordinary promissory notes taken for the unpaid balances. On December 30 or 31, 1895, the corporation being again unable to meet its maturing obligations, sent telegraphic messages to the Rubber Companies, in response to which Charles L. Johnson and Huston M.

Sadler, Jr., as representatives of those companies, which some months before had become one in interest, went to Chicago, arriving January 2, 1896, and on the evening of that day commenced with Charles E. Fargo negotiations which on the 6th terminated in the agreement, the character of which is now the subject of the dispute. In those negotiations Johnson and Sadler were assisted and advised by the local counsel of the Rubber Companies, Mr. Wm. A. Beale, who was present at most of the interviews. At that time there was due from The Fargo Company to L. Candee & Co., as evidenced by notes given in settlement the preceding November, $44,900, to the United States Rubber Company, on open account for the proceeds of sales of consigned goods, $141,537.13, to the Metropolitan National Bank, $50,000, and to others $210,216.20—a total of $416,653.33. The value of the assets at that time was not definitely ascertained, but was represented by the Fargos to exceed largely the liabilities. In fact it was much less.

Johnson, on arrival, was told of the company's embarrassment, and was asked to have his companies make a loan of $25,000 to meet paper soon to mature. He refused the request and solicited security for what was owing to his companies, urging that on account of what they had done in 1893, they were entitled to preference over other creditors. That meant and was understood to mean an immediate suspension of business, and was refused by Charles Fargo, who insisted that a failure was not necessary, and that if they had to go to the wall they would treat all creditors alike. The negotiations then proceeded, but

without result, until January 6th, the whole effort for four days, so far as disclosed, being expended in the endeavor to devise a plan whereby the Rubber Companies could be made absolutely secure, and the Fargo Company be able to continue in business. The idea of putting the board of directors under control of the Rubber Companies having been suggested, and it having been determined that the loan had better be $50,000, Johnson, acting for the L. Candee & Co., then proposed to lend the Fargo Company $50,000 for six months upon the understanding that the loan and the previous indebtedness for $44,900 and the debt due and to become due to the United States Rubber Company "should be secured "in such way as might be satisfactory to their coun- "sel, Mr. Beale." This proposition was accepted on the same day, and as the Master's report proceeds to say, "it was agreed and arranged between the parties as follows:

First. That the $50,000 should be advanced to the Fargo Company by L. Candee & Co., partly on that date and during the succeeding two weeks.

Second. That the Fargo Company should that day execute and deliver its three judgment notes, one for $45,000 payable on demand to the order of L. Candee & Company, to secure that company with respect to its liability as endorser or guarantor upon the notes for $44,900 given previous to January, 1896, one for $51,500 payable on demand to L. Candee & Company as collateral security to plain notes of the Fargo Company which were given as evidence of the advance of $50,000 then to be made, and one for $140,000 payable on demand to the order of the United States Rub-

ber Company, as collateral security to the then existing and to any future indebtedness of the Fargo Company to the United States Rubber Company as aforesaid.

Third. That in case the Fargo Company should at any time find it necessary to suspend business, it would assign as additional security all its accounts and bills receivable; that it should not give any judgment notes to other creditors which would impair the security to the Rubber Companies, and that the $50,000 advance should be used by the Fargo Company in reduction of its general indebtedness as it matured; and

Fourth. That the four employes of the Fargo Company who were on the board of directors, and also E. A. Fargo, should retire from the board and there should be elected in their places by the stockholders of the company, five persons to be nominated by said Beale, in whom he had confidence, one of whom should become secretary and treasurer, and that the directors so to be elected at Beale's nomination should not hamper or interfere with the proper carrying on of the ordinary business of the company."

On the same day a meeting of the board of directors of the Fargo Company as then and theretofore constituted was held, at which was passed a resolution authorizing the borrowing of the $50,000 and the giving of judgment notes therefor and for existing indebtedness as stipulated, and accordingly three judgment notes "were executed and delivered by Charles "E. Fargo, president of the company, Frank M. "Fargo, vice-president and treasurer, and E. A. "Fargo, secretary, and the loan of $50,000 was per-

"fected, $10,000 being advanced at the time and the "balance of $50,000 during the succeeding two "weeks." This action was ratified on the 8th day of January, 1896, by the unanimous vote of the stockholders of the company, all the shares being represented. The three Fargos had been for some time the owners of all the shares. An effort was made to reduce to writing the understanding, but Charles Fargo insisted upon terms to which Mr. Beale would not assent, and Mr. Johnson, who was on his way eastward, being informed of the situation, sent from Altoona, Pa., on January 7th, a telegram to Mr. Beale, containing the following:

> "Sadler has explained the situation to me. "Think position should be made absolute, as soon "as possible, by completing arrangement as ar- "ranged and organization of directors to pre- "vent giving other judgment notes. * * * "Failure thus to protect us should result in exe- "cutions by us. Use, at your discretion, all "judgment notes in your possession, in order to "put our claim beyond peradventure."

This having been read to Mr. Fargo, he consented to trust Johnson in the matter without a written agreement.

At a meeting of the stockholders on January 9, 1896, George C. Madison, Tiffany Blake, Buell McKeever, Frederick B. Fuller, Gilbert E. Porter, Charles E. Fargo, and Frank M. Fargo were elected directors for the ensuing year, all except the Fargos and Blake being employes in the office of Beale, and Blake being assistant Corporation Counsel of the City of Chicago, of which Beale was then Corporation Counsel; and all except the Fargos were chosen at the

suggestion of Beale. At a meeting on the same day of the newly-elected board, Charles E. Fargo was re-elected president of the company, Frank M. Fargo vice-president, Basil McKeever was made secretary and treasurer, and the by-laws of the company were so amended as to forbid the giving of judgment notes or preferential security without special authorization from the board of directors. The change of the board of directors and officers, the change in the by-laws, and the resolution authorizing the execution of judgment notes and an assignment of accounts, the Master reported, "were all for the purpose of giving "preferential security to the Rubber Companies, and "the matter was kept secret in order to allow the "Fargo Company an opportunity of getting through "embarrassments apparently temporary, but not with "a fraudulent intent as to the other creditors of the "company." The report then proceeds:

> "The only purpose and object of changing the "board of directors as aforesaid and of amending "the by-laws was to protect the Rubber Compa-"nies against the giving by the Fargo Company "of preferential security or judgment notes to "other creditors, which should be superior (or "equal?) to the security of the Rubber Companies. "* * * The arrangement as made was car-"ried out in good faith by the parties, and the "directors elected at the suggestion of said Beale "took no part in the active management of the "Fargo Company after their election, and no "stockholders' or directors' meetings of the Fargo "Company were held after January 9th, 1896, "until August 5th, 1896."

It further appears that between January 6 and August 6, 1896, new liabilities were incurred by the

Fargo Company to creditors other than the Rubber Companies and the Bank to the amount of $246,660.54, of which there was due and unpaid on August 6, 1896, $142,690.95, and during the same period the Fargo Company paid to general creditors in the regular course of business more than $300,000, paying all of the indebtedness of January 6, 1896, which was largely to persons who are now creditors. Charles and Frank Fargo were personally liable upon portions of the debts of the company in January, and those portions were paid off before August. The original debt of $44,900 to the Candee Company was paid, and $13,470 on the loan of $50,000. To the United States Rubber Company as much as $15,000 was paid on old indebtedness, but additional consigned goods were sold to the amount of $24,534.04, of which the sum of $5,534.04 only was remitted, so that the sum due that company on August 6 was $142,424.81, and there was due to L. Candee & Co. $36,530. All credit given to the Fargo Company after January 9, except by the Rubber Companies and $10,000 by the Bank, was given in ignorance of the execution of the judgment notes to the Rubber Companies, of the change of directors and officers, and of the arrangement existing between the Rubber Companies and the Fargo Company. Of the liabilities so contracted the amount still unpaid exceeds $110,000. Besides the mere ignorance of the facts reported by the Master, the evidence shows that in order to obtain credit of the banks at Dixon it was represented in response to direct inquiry that the company had given no judgment notes, and to the representative of another creditor, the Pfister &

Vogel Leather Company, seeking payment or security, Charles E. Fargo, while denying that he had made a direct statement that the company had given no judgment notes, admitted that in response to inquiry he had made evasive answers likely to produce, and which he intended to produce, that belief. His testimony on the point presents an interesting picture of one who in all this transaction is credited with having had no wrongful purpose. About the last of July it became evident that a collapse was inevitable, and with that result in view, Charles Fargo, desiring money for the individual uses of himself and brothers, sought to obtain for the company from the Metropolitan Bank, to which there was then owing $40,000 unsecured, an additional $10,000. His plan was to have the Bank admitted into the arrangement with the Rubber Companies, and for the purpose of obtaining the consent of those companies he went to New York. He obtained the desired consent, but, according to the testimony of Mr. Sadler, without revealing the purpose to cease business. Mr. Sadler returned with him, or after a day or two followed him to Chicago, but for what purpose is not disclosed. Though not admitted, it is difficult to believe that he left Chicago without knowledge of what was being and about to be done.

In respect to the coming of the Bank into the arrangement with the Rubber Companies, the Master found, among other things, "that C. H. Fargo repre-
"sented to the president of the Bank that C. H.
"Fargo & Co. was indebted to him and his brothers for
"money exceeding $10,000, which they had borrowed
"upon their notes for the benefit of the company, and

"which they had paid over to the company for use in its "business, and that said Fargo Brothers had put up "some bank stock that they owned as collateral to said "notes; and C. E. Fargo thereupon proposed to said "Bank that if it would loan said C. H. Fargo & Co. "$10,000 in addition to its then existing loan, so that "said company could reimburse him and his brothers "and enable them to take up said notes, he would "procure from the said C. H. Fargo & Co. judgment "notes for said Bank, both for said sum so advanced "as aforesaid, and also for the notes then remaining "due said Bank to the amount of $40,000."

Without a further rehearsal of details, it is sufficient to state that the Bank was informed of the arrangement with the Rubber Companies, consented to join in it, advanced the additional $10,000, making its entire demand $50,000, received therefor two judgment notes for $25,000 each, accepted in immediate payment of one of them a conveyance by the Fargo Company of its manufacturing establishment and plant at Dixon, and contemporaneously entered into an agreement with the Rubber Companies that each would account to the other, and divide all sums realized *pro rata* according to the amounts of their respective claims. The Bank and the Rubber Companies proceeded at once to take judgments and to cause executions to be issued and levied. The accounts of the Fargo Company were assigned to the Rubber Companies as stipulated, and were placed in the hands of Mr. Beale's firm for collection—an arrangement which was continued by order of the Circuit Court, and the amounts realized therefrom and from the disposition of the property by the Marshal have been duly reported.

Exceptions were filed to the Master's report by the American Oak Leather Company, and by that company jointly with the other complainants, all of which the court overruled. Errors are assigned by the Rubber Companies jointly, and separately by the Metropolitan National Bank, and by the United States Rubber Company. The errors assigned on the cross-appeal are directed to the rulings upon exceptions to the Master's report as well as to the final decree.

Woods, Circuit Judge, after stating the case, delivered the opinion of the court:

Questions of fraud in law and fraud in fact are in their natures separate, though not always distinguishable by clearly defined lines. In this case they have been presented separately in the briefs, and in the argument at the bar of the court, but the facts bearing upon them are so commingled and to a large extent inseparable, that to avoid repetition no attempt will be made as we proceed to keep the distinction all the while in view.

There can be no doubt that the question of the validity of the preferences given to the Rubber Companies and to the Bank, should be determined by the law of Illinois where the attempt to give them was made. That law, it is also certain, authorizes judgment notes and permits the preferring of creditors by insolvent debtors, whether individual or corporate; and reference has been made to the decisions in *Field* v. *Ridgely*, 116 Ill., 424; *Hegeler* v. *First National Bank of Peru*, 129 Ill., 157, and *Haas* v. *Sternbach*, 156 Ill., 44, for adjudications of the validity of preferences obtained by means of judgment notes which had been withheld from record "for four years" "for

more than a year" and "for five years" while the debtor continued in business, obtaining, as it was alleged, new credit which would have been refused if the existence of the judgment notes had been known. In *Hegeler* v. *The Bank*, mortgage security had been offered by the debtor, but refused by the creditor, "because it would injure the credit of the glass "company and prevent it from obtaining credit else- "where." The court in that case said:

> "The argument proceeds throughout upon the proposition that the bank took its notes and held them under circumstances that made its conduct operate as a fraud upon others. There is no pretense that there was any agreement to conceal its claim against the glass company; much less that any such agreement was made for the purpose of enabling the company to obtain credit from others. No evidence can be found in the record proving, or tending to prove, acts or declarations on the part of appellee calculated to induce appellant to give credit to the glass company. There is nothing in the bill and certainly nothing in the evidence, to show that at the time appellee took the notes, and refused to take mortgage security, it did not honestly believe that, notwithstanding the insolvency of the glass company, it would, if its credit could be maintained, successfully recover from its embarrassment, continue business and pay all its debts."

In *Haas* v. *Sternbach*, a mortgage on real estate, kept off the record at the request of the mortgagor with the view to an early sale of the property, was pronounced not fraudulent as against creditors of the firm of which the mortgagor was a member; but an important distinction of that case, as well as of the preceding one, from the present, was marked by the court when it said:

> "There was no agreement or promise to keep the mortgage secret, but simply that it would not then be recorded; and there is an entire absence of proof that Charles Sternbach or his firm did or said anything other than withholding the mortgage from record, which could have misled others as to its existence."

"Thus, in Illinois it is clearly established law" say counsel, "that the maintenance of secrecy respecting "a preference without fraudulent intent as to other "creditors,' does not make the preference fraudulent": and to reinforce the proposition they cite *Sanford Fork & Tool Co.* v. *Howe*, 157 U. S., 312; *Sutton Mfg. Co.* v. *Hutchinson*, 24 U. S. App., 145; 11 C. C. A., 320. Whatever may be thought of the legislative policy which permits the execution and long holding of unrecorded judgment notes, the decisions cited afford no precedent, direct or inferential, in justification of the scheme in question, the like of which, we believe, if ever conceived, never before was brought into effective operation. As a judicially sanctioned or commercially accepted possibility in business it is unbelievable. It could be attempted only by a corporate debtor; and its approval by the courts would afford a new and fruitful motive for the creation of corporations by the many who would be quick to avail themselves of so promising a method of pursuing hazardous enterprises at the risk of others.

"The maintenance of secrecy," to repeat the words chosen by counsel to express the scope of the decisions referred to, does not signify necessarily more than the fact of secrecy, begun and continued without previous agreement or purpose to maintain it; but secrecy kept for a specific purpose means much more. The Mas-

ter's finding on the point implies, and the evidence demonstrates, a mutual understanding between those concerned that secrecy was necessary, and an express agreement that it should be kept would not have made the understanding more clear, or its fulfillment more imperative. During the negotiations the suggestion of a chattel mortgage was advanced, but promptly rejected, because without the publicity of recording the security would be invalid against other creditors. The scheme adopted, which, if upheld, though not constituting a recognized form of lien, would be a better security than a chattel mortgage, was accepted not only because it made secrecy possible, but because it made exposure impossible, if those employed to execute it kept faith; and that every one of them understood or was made to understand, that once the scheme was on foot his chief responsibility would be to maintain a discreet silence, the proof is clear, and there has been no attempt or apparent disposition to deny. Returning to the language of the report: "The matter was kept secret in "order to allow"—that is to say for the purpose of allowing—"the Fargo Company an opportunity of get"ting through embarrassments apparently tempo"rary"; and that of course, and avowedly, they were to do, or try to do, by continuing the business under a plan, which without secrecy was known to be impossible, and by which the risks of the business were shifted wholly upon those who, not suspecting the situation, should give undeserved credit. Secrecy kept for a purpose is not accidental or unintended. It is premeditated; it is in essence the same as if agreed upon; and the color imparted by it to this transaction, when

all the circumstances are considered, is not removed by the added words of the finding, "but not with a "fraudulent intent as to the other creditors of the com- "pany." Read strictly, that part of the finding is not broad enough to include subsequent creditors, against whom the scheme was so plainly wrongful that Charles Fargo, who is credited with having suggested the making of a change in the directory of his company, after a while became unwilling to pursue it further by seeking renewals of the company's notes in bank. If, however, the Master intended, as it seems probable he did intend, to find that the parties to the scheme had no conscious purpose to harm either present or future creditors, the finding can not abrogate or restrict the application of that familiar rule, without which a coherent code of law or morals would be impossible, that men shall be deemed to intend the natural and probable consequences of their acts or conduct. What did these people intend "as to other creditors"? Plainly that they should remain or become creditors without security or the possibility of obtaining it and be at the mercy of themselves, who by a secret control of the corporation, were to be able at any hour to close its doors and appropriate all its property to the payment of their own demands. There is a pertinent passage in the testimony of Mr. Beale. After explaining that he had personally cautioned Charles Fargo against being too hopeful, being inclined to branch out, and possibly having too much time to go fishing, and telling him that "he was all right if they handled "their business as it ought to be handled," he added: "They had started with a big business and ought to "be able to carry it along even through these hard

"times, but I was particularly desirous that through "any strong temptation he should not put the Metro- "politan Bank in a position where it could claim to "have been deceived. I do not think that the idea "of other creditors, merchandise creditors, or their "position, entered the mind of either Mr. Johnson or "Mr. Sadler or myself during the entire transaction; "we were thinking of the Metropolitan Bank and were "anxious to see that that indebtedness should not in- "crease after we made the arrangement, and that sub- "ject—reference to the Metropolitan Bank—formed "the subject of some conversation between Mr. John- "son and myself, and I distinctly remember at one of "the interviews at the Auditorium Annex saying that "Fargo after that must not go to the Metropolitan Bank "to borrow additional money. We had in mind that he "would not need to increase the credits after getting "this $50,000 from the Rubber Companies." One creditor, at least, was important enough to be thought of and talked of, and to be the object of solicitous care that "through any strong temptation" Fargo should not put it in a position where "it could claim "to have been deceived." What stronger condemnation could there be of the scheme, or better proof that its essential character was apprehended (though unconsciously, according to the Master's finding) by those about to put it into operation? There were potent reasons for thinking of the Bank, and for desiring that it should not have ground for asserting deceit. Mercantile creditors were further away and individually of much less importance, it is easy to see, than the Metropolitan National Bank with which it was a part of the plan to keep up, though it seems not

to increase, the Fargo Company's line of credit; but all that only emphasizes the wrong done in forgetting others, equally entitled to consideration, if they were forgotten, and if they were purposely left out of consideration still greater was the wrong. The apprehended power of temptation proved too strong for one of the Fargos when he obtained credit of the Dixon banks by a direct denial that judgment notes had been executed, and for another of them when, by an evasive denial, he intentionally produced the same belief. Mr. Beale, concerned only with the legal aspects of the situation and pressed with other business, testified as he remembered, but is it possible to believe that neither Johnson nor Sadler, during the four days devoted to this one matter, thought and talked of the bearing of the transaction upon one creditor, the Bank, and did not think of its import either to those who should give credit in the future, or to present creditors whose demands were a factor in the situation and could not have been omitted from an intelligent estimate of what had been and must be done. Their testimony contains no assertion or admission of such forgetfulness.

The inventors of the scheme were bound to apprehend its probable consequences, and in fact nothing occurred after January 9, when it was put into operation, which was not then reasonably to have been foreseen. The large existing indebtedness, present embarrassment and the unsettled conditions of business were known; the plan then adopted to keep the business going was of course known; in all its features, it was known too that new credit was to be sought, and success was uncertain, to say the very

least, in a degree far beyond the ordinary contingencies of a new business starting well, or of an old business in an unembarrassed condition. That the Rubber Companies apprehended a break down is demonstrated, aside from other considerations, by the extraordinary and unheard of means which they employed to guard themselves against all foreseen contingencies, knowing that by the same means the consequences, however disastrous, would be turned upon others, who misled by the appearance of a well sustained and prosperous business should give credit to the Fargo Company. Two years before a like embarrassment of the company had been bridged over by an agreement with the Rubber Companies and the Bank; but judgment notes only were then required. The lapse of two years had not improved the situation. The debt to the Bank had been largely reduced and that to the Rubber Companies by a small amount, but in the aggregate the liabilities still exceeded $400,000. The assets were represented to be considerably in excess of that amount, but no examination or close inquiry was made into the truth of the representation, though it was of a character which, under the circumstances, ought to have challenged belief. To a large amount, not then definitely stated, perhaps, but in the report of April 1, 1896, to the Dun Agency, put at $366,000, they consisted of notes and book accounts; and yet, for the purpose of devising means to raise $25,000—a mere bagatelle, as a witness accepting the word from Mr. Beale called it—the representatives of the Rubber Companies were summoned on a day's notice to come from New York to Chicago, and after arrival devoted

four days to the achievement. If the notes and accounts were good, as represented, the aid of the Rubber Companies was not needed to raise $25,000, or twice that sum; or, if needed, why were not the notes and accounts turned over at once as collateral either for the $50,000 alone, or for that and the original indebtedness? They could have been put at once into the same process of collection which was employed six months later. That course could have been pursued without impairing the standing of the company. But the evident truth is, and Johnson and Sadler were not much deceived about it, that the statement of assets in that particular and in others like the plant at Dixon put down at $110,000, when in fact worth nothing over incumbrances, was greatly exaggerated, and they can hardly be credited with not understanding that the company was then practically insolvent, and, without the indulgence of its creditors, bound to close its doors. Even if the Bank and Rubber Companies had agreed to hold their demands in abeyance, the company would have been unable to meet its liabilities of $210,000 to other creditors. To say the least, and without going beyond the facts reported by the Master, the agents of the Rubber Companies knew that the Fargo Company owed commercial debts to the amount of $400,000; that while its assets were asserted to be largely in excess of that amount, they were not presently available and that the company could go on in business for the next month only by procuring a loan of $25,000, and that to be able to go on certainly for a longer time $50,000 would be necessary. It was hoped—let us say it was believed—by all concerned that with that sum, under the plan

agreed upon, the company "would be able to weather "the storm." It was a storm they knew, and no matter what they believed, without better reason than the word of their debtor discredited by facts within their own knowledge, they had no right, in an attempt to ride out the storm, to adopt a deceitful plan, which they hoped might succeed, but by which, if failure came, loss, supposed to be made impossible to themselves, would certainly befall others. They may well be credited with having believed that the assets were then sufficient and that in the prosecution of the business under the plan proposed they would remain sufficient for the payment in full of their own demands, including the added $50,000, but beyond that, if their scheme was lawful, they did not need to care, and evidently did not, during the negotiations, very much concern themselves.

It was not, as alleged in the bill, a part of the plan that increased purchases should be made for the purpose of improving the security of the Rubber Companies. On the contrary the opposite course was recommended by Mr. Johnson, and to some extent was pursued, resulting as stated in a reduction of indebtedness about equally in the aggregate to the Rubber Companies and to other creditors. There was no necessity, at least no known necessity, for a different course in the interest of the Rubber Companies, their security being supposed to be ample, and it being in their power, by means of immediate judgments and executions, to exclude all other creditors until their demands were satisfied. The notes and accounts, though not leviable by execution, they supposed could not escape

them, because they had a contract with the old board of directors for their transfer, which the new board, appointed to do their bidding, would see performed. This suggestion, it is true, goes a little beyond the finding of the Master that "the only purpose of chang-"ing the board" was to protect the Rubber Companies against the giving of preferential security or judgment notes to other creditors, but it is evident that other emergencies might have arisen that would have called for the active interference of the board, directly or indirectly for the protection of the Rubber Companies, and it is idle to say that the board was not constituted as it was for the purpose of meeting whatever emergency might arise in the interest of those companies. "Practically they sat on a safety-valve * * * "so far as protection to the Rubber Company was "concerned," answered a witness, accepting again the words of counsel, and the full significance of the figure is in the fact that the craft they were sailing, if allowed to blow up, unless the navigators should bungle their work, could not injure owners nor crew, nor certain passengers, but only those who should have come aboard in the innocent belief that the boat was one of ordinary type, and that they were exposing themselves to no risks from which the captain, crew and other passengers were exempt. And that craft, it will not be overlooked, was "a going concern," which by the mere appearance given it of stanchness and completeness of equipment, was calculated to allure the unsuspecting to a voyage beset with unwonted dangers.

It has been emphasized in the taking of testimony that the Fargos were to be left to conduct the business in

their own way, that the new board, or the new trustees, were not to interfere with them, and that McKeever, the new treasurer elect, was to be treasurer in name only. This, it is explained, was done so that if the former treasurer, who was still to be treasurer in effect, and on the letter-heads kept in use was still designated as treasurer, should join in the execution of judgment notes as in 1893 he had done, his authority could be denied by showing that he was not in fact treasurer. It was a fraud on the law to constitute a board of trustees and a treasurer of a corporation of men who, from the beginning, were pledged not to give attention to their duties or to participate in the management of the business of the corporation, further than to protect the rights of particular creditors, in whose interest alone they were given their places: and when, in addition to enjoined silence and secrecy on the subject, letters under the old form of letter-head, showing the old officers to be still in office, were sent out as they were to old customers and to new, it was an act of deception for which the Rubber Companies can not escape liability, since that it should be done was implied in the plan adopted. It was essential to the secrecy which it was understood must be preserved, and was within the stipulation that the Fargos should be allowed to keep the business going and to conduct it without interference. It is no answer to say that those who dealt with the company did not consider nor care who were the officers. A change in the names on the letter-heads could not be made because likely to excite inquiry, and inquiry implied exposure.

When it is important to know the motives of men, their conduct is to be considered rather that their asser-

tions, especially when they testify in support of large pecuniary interests, either their own or of others, put at hazard by their conduct.

In the negotiations of January, Charles Fargo, at the beginning was master of the situation. He was able to compel and did compel Johnson to accede to his terms, and it was only by reason of an untimely delivery of the judgment notes due on demand, before getting the written agreement which he desired, that he found himself in Johnson's power, and Johnson determined upon immediate action, willing as he had declared himself a day or two before to lose $25,000 or $50,000 rather than that the Fargo Company should fail. What Johnson wished and sought at the beginning was security for the $186,437.13 due his houses, and when denied that on terms which involved an immediate suspension of the Fargo Company, he began to negotiate on the basis proposed of a loan to enable the company to continue in business. Touching his own motives, Charles Fargo testified to a belief that suspension was not necessary, and would not be. He was either purposely ignorant of the situation or unreasonably hopeful. He had a special motive however for seeking to escape immediate surrender, in the fact that he and his brother Frank were indorsers upon the company's paper to other creditors than the Bank and Rubber Companies to the extent of $15,000, and if the business could be kept going a few months that paper could be taken up. It was taken up before the collapse in August. The Fargos, therefore, were acting probably under two motives—one to keep the business going, with whatever hope they had of ultimate success, and the other to keep it going long

enough to pay off the obligations of the company on which they were personally liable. The controlling purpose of Johnson was to get security, and in order to get it he yielded to the request of the Fargos for a loan, increasing by that sum the demands of his houses. That price he consented to pay in order to obtain security for the whole indebtedness, believing the security adequate under any contingencies likely to come about during the ensuing six months deemed necessary for the working out of the scheme. He was willing, perhaps in a degree hopeful, that the Fargos should succeed, and that other creditors should not suffer, but except for the interest of the Rubber Companies and the integrity of their security he was practically indifferent, and any attempt to put him in any other attitude in the transaction strikes us as unnatural, unbusinesslike and incredible.

In August, as in January, Charles Fargo was able to dictate terms to the others concerned in what was then to be done. This time he had nothing to lose but something to gain for himself and brothers and for the Metropolitan National Bank, of which he was a stockholder. In January, it appears, he opposed the suggestion of admitting the Bank into the arrangement with the Rubber Companies, and it is, perhaps, not crediting him with too much acumen to suppose that besides other considerations he saw the advantage of holding that card for the last play. As an original proposition it is not probable that the Bank would have joined in the scheme, but in the end it was at his mercy, because without yielding the $10,000 it must lose its unsecured $40,000, or bring a suit in court, by which, at best, only a small percentage could be

saved. The Rubber Companies could not oppose him without danger of losing the book accounts and bills receivable which had not yet been assigned, and without exposing their judgment notes to attack by the Bank supported by the Fargos, who, perhaps, were the more to be respected because "knowledge is power." But for the "pressure" which Fargo was able to bring upon them, what businesslike reason was there for the Rubber Companies consenting to share their security with the Bank, if they believed it unimpeachable? Whatever they thought in January, they knew then that the property within reach of the executions which they could obtain was insufficient, and with the accounts receivable added would hardly realize enough to satisfy their own demands. When the agreement was made with the bank, stipulating that each party should account to the other for a prorated share of all sums realized, it is evident that all expectation of full payment had been abandoned. It is recited in the agreement that the parties had "determined to unite their efforts to col-"lect their respective claims, * * * and share "*pro rata* in the results thereof," but nowhere is there a hint of a possible surplus to divide. The Fargos had carried away their $10,000, the reward for their share in what had been done, and there was no reason, apparent at the time, for inserting in the agreement even a formal expression of the residuary rights of the Fargo Company or its victimized creditors.

The assignment of the bills and accounts as finally made, treated as the consummation of the agreement to assign made in January, was tainted with the ille-

gality of that contract of which it was a part; and if it could be regarded as an independent act, freed of the tainted origin, it was illegal because part of a transaction by which the managers of an insolvent corporation, going out of business, secured a preference for themselves. If the Fargo Company was justly indebted to Charles and Frank Fargo for money which they had borrowed upon a pledge of their bank stock, and the $10,000 obtained of the Bank was for the purpose of enabling the corporation to repay them, it was, under the doctrine of *Sutton Mfg. Co.* v. *Hutchinson*, *supra*, an unlawful preference, and made illegal any other preference granted wholly or partly in consideration thereof. This proposition applies also to the preference given to the Bank. Besides being managing officers, the Fargos were parties to the original scheme for securing the Rubber Companies, and of course could not prefer themselves over others whom by the false pretenses of that scheme they had induced to give credit to the corporation.

It is contended in behalf of the Bank that it entered into the agreement with the Rubber Companies in ignorance of their arrangement with the Fargo Company, that there was no wrong in its conduct, that nobody was harmed thereby, and therefore, that whatever may be said of the position of those companies, the preference which the Bank received is not assailable merely because of its contract to join the Rubber Companies in efforts to collect their respective demands and to prorate the proceeds. The Master has reported that at the time of the completion of the arrangement, "neither the Bank nor its officers nor "attorneys had any knowledge of the change of di-

"rectors of the said C. H. Fargo & Co. or of its by-"laws." The president of the Bank testified concerning his knowledge on the subject. It does not appear that other officers of the Bank had anything to do with the matter, and the finding in respect to them is unobjectionable, but if there is evidence in the record we have not found it, that the attorney of the Bank who conducted the negotiations and is shown to have had a much more intimate knowledge of the details of the transaction than the president, did not know every feature of the original scheme. The president of the Bank himself testified that when he agreed to loan the $10,000 he knew it was necessary to get the authority of the directors for the execution of the judgment notes for the whole sum of $50,000; and that on his asking Porter when the judgment notes would be made, "he said it was easy to make "them—that the directors were all in that office" (Beale's), "or could be gotten." That certainly ought to have put him upon inquiry into the reasons for so extraordinary an organization of the directory, and in an earlier part of his testimony, after denying knowledge that the Fargo Company was officered by parties representing the Rubber Companies, and being asked when he first learned that persons were acting in behalf of the company other than those connected with its management, in the sale of goods, he answered: "It might have been the day following: "I think it was from something which was said in "Mr. Beale's office by Mr. Porter. My impression "is that he said that the directors of the company "were men who were employes in the office there, or "were part of the firm, of the law firm there." And

again on cross examination, he admitted that he did learn "of the extent of the indebtedness to the United "States Rubber Company and L. Candee & Company, "and also learned that they had some kind of an agree- "ment with the Fargo Company by which they were "authorized to secure their indebtedness in advance "of any other creditors of the company." This, it is certain from his own testimony, occurred before the judgment notes to the Bank were executed, and before the $10,000 was paid over. If the witness testified to his knowledge or ignorance of the change in the by-laws we have failed to find the passage; but it is not of much importance in view of what he did well understand. Besides, if the Bank were acquitted of all guilty knowledge and purpose in the transaction, how can it escape the entangling alliance into which it entered with the Rubber Companies? The agreement between them is still in force, and if the Bank is allowed to retain its preference it will be bound to pay over to the Rubber Companies of what it realizes in the proportion of $14 to every $5 received to its own use; and if the preference be set aside and the Bank permitted to share *pari passu* with other creditors, except the Rubber Companies, of the amount so received, great or small, it will be bound to account to the Rubber Companies in the same proportion. The validity of that agreement as between the parties is not in issue and can not be affected by the decree in this case. If unlawful and invalid as against other creditors because made in fraud of their rights, it is nevertheless binding between the parties, and could not be annulled at the suit of either against the consent of the other on account of anything done in this case. Courts of

equity do not interfere to relieve parties from the consequence, though unexpected, of illegal agreements. Moreover, the Bank if permitted to share in the fund to be distributed, the Rubber Companies being excluded, would receive more in proportion than if the preferences had been upheld, and the division were made between it and the Rubber Companies. It is clear that the Rubber Companies were guilty of fraud in fact, and as against subsequent creditors of the Fargo Company, should not be allowed to share in the fund for distribution, and for the reasons stated the Bank likewise should be postponed.

The fact that some of the creditors were creditors when the arrangement between the Fargo Company and the Rubber Companies was put into operation can not be allowed to change the result. It is impossible to say that they were not injuriously affected, even in respect to their prior demands, and it is certain that they would not have given further credit if there had been proper publicity about the things done which were purposely kept secret from them. The innocent creditors, whether prior or subsequent, are all entitled to share proportionately in the fund. The Rubber Companies and the Bank are not entitled to share as against the subsequent defrauded creditors, and therefore can not be permitted to share with the prior creditors, since thereby they would be sharing with those who were defrauded.

The principal appeal is denied; the cross-appeal is sustained, and the decree below is reversed in so far as it permitted the Rubber Companies and the Bank

to share *pari passu* with other creditors, and the cause is remanded with direction that the decree be so modified as to require the payment in full of all claims of other creditors, if the fund be sufficient, and that if anything remains it be paid proportionately to the Bank and to the Rubber Companies.